



China: Cosmetics and Toiletries

Shen Yan

Summary

China's cosmetic market has been expanding rapidly over the past 20 years. Despite this significant growth, China's cosmetic consumption is still far from saturation, and the country is expected to remain a dynamic market. Nationwide sales are expected to grow at an average of 10 percent in the years ahead according to the China Association of Fragrance Flavor and Cosmetic Industry.

Market Demand

With a population of 1.3 billion, of which 480 million are urban residents, China has the largest number of potential cosmetic customers in the world. As a result of China's fast economic growth, living conditions should continue to improve, providing an increasing number of people with purchasing power to buy cosmetics.

Despite rapid growth, China's cosmetic market is still at a low level of development. Although China is potentially the largest customer base in the world, its per capita yearly spending on cosmetics is only \$5 - \$7. Despite this, China provides reasonable business opportunities for foreign cosmetic producers, particularly in the areas of imported middle and high end products. After 20 years of development, China's cosmetic market has become highly competitive. However, there remains potential for new entrants, provided that they adopt appropriate market entry strategies, find the right manufacturing or distribution partners, use effective marketing strategies, and make suitable products for various customer groups at reasonable price points.

Market Data

Sales of cosmetics and toiletries in China reached RMB 120 billion in 2008 (around US\$ 17.6 billion), according to China Association of Fragrance Flavor and Cosmetic Industry.

The continuous double-digit growth of the Chinese beauty market is driven by both rising disposable income and fierce competition motivating female and male urban white-collar workers to invest in their personal appearance. According to Euromonitor International, a leading market research firm, the Chinese beauty market could grow up to RMB 140 billion (US\$ 20.5 billion) in 2010.

Best Prospects

Skin Care Products:

Compared to other product segments, sales of skin care products have experienced the fastest growth in recent years. Competition in this market is fierce with prices and target customers varying significantly. The market segment for middle grade products is increasing. Domestic products are more price competitive than imported ones. However, the attraction for higher quality, name brand products is solid. Facial products especially designed for Asian skin are well received by Chinese consumers. Creams and lotions have the largest sales volumes followed by facial wash creams and bath creams.

Make-up Products:

These products have great sales potential. Advertising and sales promotions greatly influence the purchasing decisions of make-up products. Consumers usually require make-up to reflect their personal styles. As such, various brands share this market. No one brand has an overwhelming market share. Lipstick represents the largest sales among make-up products.

Baby-Care Products:

The market for baby-care products has been expanding in recent years. Given the one-child policy, many parents in China do not hesitate to increase spending for their only child. Johnson & Johnson holds the largest market share in this sector. Domestic products are competitive in price, but weak in new product development. Many young women and mothers also like to use baby or children's skin care products as they are gentler and allergy-free.

Sunscreen Products:

As the awareness about the harm of ultraviolet rays increases, the market for sunscreen has grown at an average rate of 20% annually in recent years according to the China Association of Fragrance Flavor and Cosmetic Industry. Waterproof sunscreen products are enjoying increasing sales, and sunscreen products with whitening functions are also gaining favor among young Chinese women.

Key Suppliers

A recent survey conducted by China's leading internet search engine Baidu.com shows that there are more than 3,000 cosmetic enterprises registered in China with more than 20,000 brands. Of all the brands, over 500 come from foreign countries with France, the United States, Japan and South Korea being the 4 largest brand origins.

Over the past two decades, foreign companies have been very successful at increasing brand awareness in China. Although several large domestic firms are trying to catch up in their brand building, foreign companies still dominate the market. According to the China Association of Cosmetic Industry, foreign cosmetics brands currently account for 50 percent of sales volume, as they occupy almost all of the high-end market. And many of them are now expanding into middle and low end markets. Leading players/brands include P&G, Unilever, L'Oreal, Henkel, Shiseido, Wella, Revlon, Chanel SA, Lancôme, Yue-Sai, Dior, Estee Lauder, Maybelline, Vichy, etc.

Despite the economic downturn, L'Oreal, the world's largest cosmetic company by revenue, registered a strong sales volume of 6.95 billion yuan in 2008, an increase of 27 percent over the previous year. Sales in China account for 4 percent of the cosmetics giant's global market pie making it one of the 10 most important markets worldwide for the company.

Prospective Buyers

Department stores, specialty stores, professional beauty salons and some commercial websites typically buy and/or sell cosmetics in China.

Department Stores

Department stores are known in China for retailing high-quality products. As such, most of the prominent international cosmetics companies sell their products through high-end department stores in China's metropolitan areas. Department stores must, however, closely monitor the quality of the products that they retail, as some international cosmetics products are counterfeits or smuggled into China without proper official registration to guarantee their safety and quality.

Nowadays, most department stores in China tend to source products from distributors rather than source directly from manufacturers, as they do not want to spend too much time going through the lengthy registration process for cosmetic products.

Specialty Stores

These stores retail the products of famous international cosmetics companies and a variety of small to medium-size domestic companies. Many specialty stores are now contacting manufacturers directly for their cosmetics supplies, thus bypassing the wholesalers. SaSa, a leading cosmetic retailer based in Hong Kong, has opened more than 20 stores on the mainland in Beijing, Guangzhou, Chengdu and Shanghai. The total number of its stores in mainland China is expected to hit 100 by 2011. SaSa has 54 stores in Hong Kong and Macao, 13 in Singapore and 15 in Malaysia.

Sephore, which is a member of the luxury brand holding company Moët Hennessy Louis Vuitton, has experienced higher sales growth in China. Since opening its first Chinese mainland store in Shanghai in 2006, it has expanded to 30 stores in 8 cities and it is aiming to increase the number of stores to 100 by 2010 to cover all major cities in the country.

Beauty Salons

Beauty salons have been opening rapidly in China. A large number of high-end beauty salons and clubs are located in hotels, office buildings and high-end department stores. These beauty salons require their customers to register as members before receiving services. The salon's skin care services are used regularly by these members. The majority of the skin care products used in beauty salons are products from foreign companies, as customers prefer the higher quality and effectiveness.

Internet

Shopping on-line has grown rapidly in China in recent years. In terms of selling cosmetics, however, few big foreign cosmetic companies have ever sold products on the internet. This is largely due to the slack enforcement of the country's IP protection. Although many young consumers, especially students and low-income earners, tend to buy cosmetics from B-to-C websites such as Taobao.com, often times they would find out that the products delivered to them (which are a lot cheaper than the ones sold at department stores) are fake ones. Generally speaking, on-line shopping websites like Taobao.com do not sell cosmetics themselves. But rather, they only provide a platform for individuals to buy and sell things freely on their websites. As such, nobody really knows where those products have come from. Therefore, unless companies are seriously dedicated to establishing their own e-commerce websites, selling on the internet in China is not strongly suggested given the current environment.

Market Entry

Distribution Companies

When it comes to selling imported cosmetic products, finding a local distributor often is the first and most preferable option. Good local distributors understand the market situation very well and can tell if a new-to-market product has any potential in China. More importantly, local distributors are in the best position to help new-to-market foreign companies navigate the very complicated import and registration process with different Chinese government agencies, thus significantly saving time for foreign companies wanting to enter the Chinese market.

Direct selling

Direct selling has historically been a popular channel for selling cosmetic products into different markets. However, direct selling in China has a turbulent history and still contains legislative challenges. As part of China's WTO commitment to allow market access for "wholesale or retail trade services away from a fixed location" by December 11, 2004, China issued two long awaited regulations governing the sector on September 2, 2005. Upon analysis, these new regulations are more restrictive than those of any other

country in the world. Multi-level marketing (MLM) organizations are characterized as illegal pyramids, compensation is capped at 30% based on personal sales, and language exists which will require the construction of fixed location “service centers” in each area where sales occur. Significant barriers exist for new entrants, as evidenced by a 3-year foreign experience rule, an actual registered capital of 80 million RMB (US\$10 million) and a required 20 million RMB (US\$2.5 million) bond deposit.

There are currently 10 to 12 large-scale international firms in China that have been operating under direct-sales model. Given the very strict requirements, companies should carefully consider whether they want to adopt the direct selling model in China.

Localized production

To gain a firm footing in China, many foreign cosmetic companies have chosen to set up factories in China. Most of the foreign brands that are selling well in China are now manufactured in China. Usually these foreign companies would set up factories at development zones or industrial parks near the big cities, like Beijing, Shanghai and Guangzhou, to capitalize on lower production costs. While the initial investment for setting up a factory could be huge, it brings key benefits such as being closer to consumers, clear sales channel, easy control over brand image and lower labor cost. P&G, for example, has set up several manufacturing facilities across the country allowing it to compete with domestic counterparts even on prices, a fact that would be impossible without the localized production.

In addition, foreign cosmetic firms have attached great importance to the development of ‘China-specific’ products in the long run. L’Oreal opened a skin and hair research institute in Shanghai in 2005 that will create products designed specifically for Chinese women. Shiseido, Japan’s biggest cosmetics company, is expanding a similar research facility in Beijing, where its China headquarters is located. According to media reports, both companies say they will experiment with traditional Chinese herbs with the aim of including them in new products.

Acquisitions

International giants have found that acquiring local firms is one of the most effective ways to expand to second and third-tier regions, or medium and low-end markets. China has the most cosmetic manufacturers in the world and about 90% of these manufacturers are small and medium-sized firms holding a relatively small percentage of the market share. However, many of these firms have well-established regional distribution networks, especially in small cities and the vast rural areas that foreign brands have yet to take. For example, French firm L’Oreal acquired Mini Nurse and Yue-Sai, both of which were famous local brands, in 2003. This deal effectively gave the firm an extended reach to many small cities that it had never been able to focus on in the past.

Market Issues & Obstacles

According to the SFDA (State Food and Drug Administration) under the Ministry of Health, People’s Republic of China, all foreign cosmetic product manufacturers must complete a safety and health quality test, and obtain a hygiene permit before they are allowed to sell in the Chinese market.

Safety and Health Quality Test

This test is performed by organizations appointed by the SFDA. At present, there are three such organizations authorized by SFDA to administer such tests. The test normally takes 2-6 months while costs vary from \$700 to \$6,000 depending on the types and complexity of the products. Following is the contact information on these organizations:

China Center for Diseases Control (China CDC)
Institute for Environmental Health and Related Product Safety
#27, Nanwei Road, Beijing 100050, P.R. China
Phone: 86-10/6302-2960; Fax: 86-10/6317-0894
www.chinacdc.net.cn

Shanghai Center for Diseases Control (Shanghai CDC)
Environmental Health Section
#1380 Zhongshan Road West, Shanghai 200336, P.R. China
Phone: 86-21/6275-8710 x 21; Fax: 86-21/6209-6059
www.scdc.sh.cn

Guangdong Center for Diseases Control (Guangdong CDC)
Public Health Research Institute
#176 Xingang Road West, Guangzhou 510300, P.R. China
Phone: 86-20/8419-7952; Fax: 86-20/8446-9324
www.cdcp.org.cn

Hygiene Permit for Imported Cosmetics

This permit is granted by SFDA. The maximum time taken to review and evaluate imported cosmetics is eight months. According to some local companies that help cosmetic firms apply for this permit, actual length ranges from two to eight months. A committee under SFDA convenes to review and evaluate imported cosmetics four times a year in March, June, September, and December. Companies need to submit the following documents:

Samples of declared product;

- Formula of declared product;
- Flow chart of production process for declared product;
- Quality standard of declared product;
- Authorization letter from exporter (when using agent for registration);
- Exporter's local sales permit for declared product;
- Quarantine Certificate from exporter's government agency.
- User's guide and usage warning for declared products.

The contact information of SFDA is as follows:

State Food and Drug Administration
A-38 Beilishi Road, Xicheng District, Beijing 100810, P.R. China
Phone: 86-10-6831-5572
Fax: 86-10-6831-5776
Email: slfwzx@sfd.gov.cn
www.sfd.gov.cn

It should be noted, however, that foreign cosmetic companies are not allowed to apply for a health permit by themselves. Instead, they need to use a local company to apply on their behalf. There are a number of local companies that provide such service.

Free Sales Certificate (FSC)

US companies exporting cosmetics to China needed to obtain a FSC from the FDA in the US indicating that their products were actually sold in the US market. Now that the FDA no longer issues such certificates to US companies, it is suggested that US companies get in touch with the Washington DC based Personal Care Products Council, formally known as CTFA (The Cosmetic, Toiletry, and Fragrance Association), to see if they can issue the certificate.

Personal Care Products Council (PCPC)
1101 17th Street, NW, Suite 300, Washington D.C. 20036-4702
Phone: (202) 331-1770
Fax: (202) 331-1969
<http://www.personalcarecouncil.org/>

Consumption tax

China introduced the cosmetic consumption tax in 1994. Since hair and skincare products were relatively expensive, the government decided to levy a 17 percent consumption tax on these products in order to balance consumption and increase its fiscal revenue. In 1999, the government lowered the cosmetic consumption tax rate to 8 percent, as improving living standards had made some of these products parts of everyday life for many families. However, the consumption tax on high-end and luxury cosmetics such as make-up and perfume products was increased from 8 percent to 30 percent in April 2006. The consumption tax for hair and skincare products remains at 8 percent.

Trademarks

Generally speaking, China's trademark registration is fairly inexpensive and straightforward. To show its commitment to WTO pledges, local judges are encouraged to promote rule of law and act against infringements on behalf of the foreign litigants. But, remember that China's system is 'first to register' rather than 'first to market'. So, if you are seriously looking at this market, registering BEFORE you enter China can save a lot of time, money and frustration should you face infringement at a later stage. The worst case scenario is to have a competitor or other local firms register your brand name in the early stages of your market entry, forcing you to fight an uphill battle for your name. To learn more about protecting your trademark in China, please visit <http://beijing.usembassy-china.org.cn/iptrade.html>

Administration of raw materials for cosmetics

China's authorities have periodically updated the list of ingredients that are prohibited or restricted for use in cosmetics placed on the market.

The regulation issued by the Ministry of Health modifies the Hygienic Standards for Cosmetics, which provide the specifications for cosmetics sold in China. The new regulation adds 790 substances to the list of chemicals prohibited from use in cosmetic products, bringing the total number of substances to 1,286.

According to a survey conducted among exhibitors at the Cosmoprof show in Shanghai in January 2007, most of the foreign companies welcomed the new regulation. Some experts believe that in practice foreign cosmetics makers should not be affected by the new standard, as the newly regulated substances are already covered by the European directive on cosmetic products. Therefore, it should mainly affect local producers whose production standards are below those laid out by the new regulation.

Trade Events

Cosmoprof Asia – It is held every November in Hong Kong and is the largest cosmetic trade event in Asia.

Show date: November 11 – 13, 2009
Location: Hong Kong Convention and Exhibition Center
Website: <http://www.cosmoprof-asia.com>

Resources & Key Contacts

China Association of Fragrance Flavor and Cosmetic Industry
Website: <http://www.caffci.com.cn/>

For More Information

The U.S. Commercial Service in Beijing, China can be contacted via e-mail at: Yan.Shen@mail.doc.gov; Frank.Joseph@mail.doc.gov; Phone: 8610-8531-3557; Fax: 8610-8531-3701 or visit our website: www.buyusa.gov/china

The U.S. Commercial Service — Your Global Business Partner

With its network of offices across the United States and in more than 80 countries, the U.S. Commercial Service of the U.S. Department of Commerce utilizes its global presence and international marketing expertise to help U.S. companies sell their products and services worldwide. Locate the U.S. Commercial Service trade specialist in the U.S. nearest you by visiting <http://www.export.gov/>.

Disclaimer: The information provided in this report is intended to be of assistance to U.S. exporters. While we make every effort to ensure its accuracy, neither the United States government nor any of its employees make any representation as to the accuracy or completeness of information in this or any other United States government document. Readers are advised to independently verify any information prior to reliance thereon. The information provided in this report does not constitute legal advice.

International copyright, U.S. Department of Commerce, 2006. All rights reserved outside of the United States.